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2023 Hot topics for FRS 102 reporters

Macro-economic uncertainty

Over the previous year, there has been a notable increase in inflation, ongoing increments in interest rates and continued high energy costs. These factors, aside from affecting the economic landscape, will of course impact most companies' current financial performance and position and future prospects to varying degrees. Hence, companies should carefully assess the financial consequences that the current economic environment may have on their financial statements. Here are some key considerations:

- **Assess impairment triggers** – High inflation and rising interest rates may indicate impairment of assets, requiring impairment testing and recognition of any impairment losses. This is especially relevant for goodwill, intangible assets and property, plant and equipment.
- **Review useful lives and residual values** – The same factors may require updates to useful lives and residual values of depreciable and/or amortisable assets. This could lead to increased depreciation and/or amortisation expenses.
- **Remeasure assets and liabilities at fair value** – Interest rate and inflation changes may impact fair value measurements of financial assets, financial liabilities, investment properties, etc. Any gains/losses should be recorded.
- **Impairment of financial assets** – Higher inflation and interest rates may increase credit risk and expectations of defaults. Impairment models and losses should be re-assessed.
- **Consider impact on provisions and contingencies** – Higher input costs may require remeasurement of any provisions based on future cash flows and recognition of new ones (e.g., onerous contracts, commitments to be net-zero).
- **Update sensitivity analysis for key estimates** – Volatility requires enhanced analysis of outcomes if key assumptions change.
- **Hyperinflation** – Economies that were considered to be hyperinflationary in 2023, or to have become so at some point in the year (per the inflation data based on the International Monetary Fund (IMF) World Economic Outlook (WEO)) were: Argentina, Ethiopia, Ghana, Haiti, Islamic Republic of Iran, Lebanon, South Sudan, Sudan, Suriname, Turkey, Venezuela, Yemen, and Zimbabwe. It is anticipated that by the end of 2023, South Sudan may no longer experience hyperinflation, pending ongoing observation. When a reporting entity's functional currency is the currency of a hyperinflationary economy, the restatement of financial statements in accordance with section 31 of FRS 102 requires the use of a general price index that reflects changes in general purchasing power.
- **Narrative reporting** – The business review given within the Strategic Report should explain how the current economic affairs affect the business performance and position. Special consideration should be given to the impact on principal risks and uncertainties, KPIs, S172 statement i.e., impact on key stakeholders and decisions undertaken throughout the reporting period.

Climate related matters

Climate change can have pervasive impacts on entities in multiple areas. Robust disclosures across the annual report provide stakeholders transparency on this issue. Here are some key considerations:

Strategic report

- To the extent necessary for an understanding of the development, performance or position and impact of an entity's activity, disclose the entity's environmental matters (e.g., policies, strategies, and targets related to climate change)
- Discuss the current and anticipated impacts of climate-related risks and opportunities on the business model, operations, and financial performance. Consider both transition and physical risks
- Explain how climate-related risks are assessed, managed, and integrated into overall risk management

Directors' report

- Disclose the directors' considerations around climate-related risks and the impact on the company's future prospects
- Disclose metrics and targets used to assess climate-related risks and performance. Common metrics include GHG emissions, energy usage and water usage. UK mandatory climate-related disclosures may be needed should the entities meet the reporting thresholds

Financial statements

- Recognise provisions, accruals and contingent liabilities related to climate matters
- Assess climate impacts on asset values and consider impairment where applicable
- Disclose climate-related assumptions used in critical accounting judgments and estimates
- Update relevant accounting policies related to climate, e.g., impairment and provisions

UK mandatory climate-related financial disclosures

In 2022, the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations modified sections 414C, 414CA, and 414CB of the Companies Act 2006. These changes require publicly quoted companies and large private companies in scope to include UK mandatory climate-related information (commonly known as TCFD-aligned disclosures) in their annual reports. LLPs are also required to provide these disclosures (per The Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022)); however, these are not covered in this guidance.

Entities in scope are:

- UK PIEs with more than 500 employees (all companies that are currently required to produce non-financial information statements)
- UK registered companies with securities listed on AIM and with a workforce exceeding 500 employees
- UK registered companies and large LLPs (which are not traded or banking LLPs) that have over 500 employees and a turnover exceeding £500 million
- Traded or banking LLPs which have more than 500 employees.

These disclosures should be given in the Strategic Report in a "non-financial and sustainability information statement," which will be an extension of the current "non-financial information statement" for Public Interest Entities (PIEs). Companies that are not currently required to have this "non-financial information statement" will still be required to incorporate the climate-related disclosures within this newly introduced statement.

If the company's directors have a reasonable belief that based on the business nature and operational approach, certain or entire components of the UK mandatory climate-related financial disclosures are not essential for an understanding of the company's operations, they may omit some or all of the required disclosures subject to the provision of an explanation of the reasons for the omission in the Strategic Report.

These disclosures should be given at group level if consolidated accounts are produced, or if not covered within consolidated group reporting, at the individual company level i.e., any subsidiary which is within the scope on an individual basis, but whose parent company does not produce consolidated accounts, is required to provide these disclosures in its individual accounts.

- **Intermediate holding of an ultimate UK-parent (exemption from consolidations under S400 CA 2006)** – Intermediate holdings (and other subsidiaries) whose activities are included within a UK parent's consolidated report that complies with the climate-related financial disclosures requirements are not required to report separately.
- **Intermediate holding of an ultimate non-UK-group (exemption from consolidations under S401 CA 2006)** – Where a UK company has an overseas parent which reports on a consolidated basis, the UK company is still required to provide TCFD-aligned disclosures in its individual accounts. For a UK intermediate holding company, the scope criteria need to be applied to the combined turnover and employee figures of the group it heads, but the disclosures should relate to the UK intermediate holding company, including how climate-related risks and opportunities may affect the carrying value of the investment in its subsidiary undertakings.

The regulation came into effect on 6 April 2022, and it applies to accounting periods that begin on or after that date.

Political instability*

The effects of the continuing conflict in Ukraine on the entity's performance and position should be assessed. This is one of the factors driving the inflationary pressures discussed above. Also, subsidiaries in Russia and/or Ukraine may be considered no longer going concerns which may lead to the impairment of these investments in the separate accounts of the parent entity.

Key potential impacts in the annual report to consider include:

- **Narrative reporting**
  - Discussion of the impact of the war on the entity's operations, supply chain, sales, costs, strategy, and outlook
  - Explanation of how the entity is responding to risks such as rising material costs, supply chain disruption, cyber risks, etc, outlining any changes in principal risks and uncertainties as a result of the war
  - Explanation of the directors' assessment of risks arising from the conflict, including implications for viability and future prospects
  - Description of measures taken to support impacted employees, customers, or suppliers
- **Financial statements**
  - Recognise or update provisions for contract losses, inventory write-downs and impairment losses relating to Ukraine/Russia operations
  - Update sensitivity analysis and disclosures around critical judgements and estimates affected by the conflict
  - Assess the need for fair value adjustments e.g., for investments exposed to the region
  - Consider contingent liabilities arising from the conflict
  - Disclose in the accounting policies section any specific impacts of the conflict on the reporting period (e.g., going concern assessment)

Tax updates

- **Finance (No 2) Bill and Pillar Two impact on financial statements** – The measures within Finance (No 2) Bill 2023 are considered to be substantively enacted on completion of its third reading in the House of Commons which occurred on 20 June 2023. The measures are aligned with the Spring Budget of 15 March 2023 and includes the implementation of top-up taxes to set a minimum 15% corporation tax rate for large groups and for financial years commencing on or after 31 December 2023, as well as the implementation of a 45% Electricity Generator Levy on 'extraordinary returns'. FRS 102 has been amended to provide a mandatory exemption from accounting for deferred taxes related to Pillar Two income taxes and introduce some additional disclosures for affected entities.
- **Tax rate** – The new 25% corporation tax rate became effective on 1 April 2023.

FRC updates applicable to FRS 102 reporters

- **CRR Thematic review of climate-related metrics and targets released in July 2023** – This publication assesses quality and maturity of disclosures of climate-related metrics and targets based on a sample of 20 entities in different industries.
- **Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and FRS 101 Reduced Disclosure Framework – International tax reform – Pillar Two model rules released in July 2023** – These amendments bring in a temporary exception (effective for accounting periods beginning on or after 1 January 2023 with early application permitted) to the accounting for deferred taxes arising from the implementation of the OECD's Pillar Two model rules, alongside targeted disclosure requirements.

* This guidance does not comment on the potential effects of the Israel-Gaza war due to the high level of uncertainty at the time of this publication.

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